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In the

Supreme Court of the United States

FEBRUARY TERM 1967

NATIONAL SURETY CORPORATION,

Petitioner,

v.

RAUSCHER, PIERCE & CO., INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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I.

The National Surety Corporation, your petitioner, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above entitled case on December 13, 1966.

II.

The opinion of the Court of Appeals for the Fifth Circuit is reported at 369 F. 2d 572. It is attached as Appendix A. infra, pages A-1 through A-14. The findings and conclusions of the trial court are attached as Appendix B, infra,

pages B-1 through B-10. The date of the decree sought to be reversed is December 13, 1966, and the time of its entry was December 13, 1966. A motion for rehearing duly filed was overruled on February 13, 1967.

III.

The jurisdiction of the District Court was invoked under 28 U.S. Code, §1332. This court's jurisdiction is invoked under 28 U.S.C.A. §1254, on the grounds that:

(1) The Court of Appeals affirmed the judgment of the lower court on findings of fact and conclusions of law rejected by the lower court as grounds for recovery, and thereby so far departed from the accepted and usual course of judicial proceedings as to call for this Court's power of supervision;

(2) The Court of Appeals affirmed the judgment of the trial court on new findings which included a finding that Rauscher, Pierce was itself defrauded, which finding is not supported by any evidence, wherefore the judgment rendered is without due process of law and so far departs from the usual accepted course of judicial proceedings as to call for this court's power of supervision; and

(3) If the Court of Appeals was correct in integrating the several steps in the transaction so as to make one transaction of the purchase by Rauscher, Pierce from the Underwriter for the Water District and the sale by Rauscher, Pierce to Water Bond Purchasers, then in

refusing to offset the damages sustained in the settlement with Water Bond Purchasers by the profit realized from the sale to Water Bond Purchasers, the court has decided an important question in conflict with applicable state law requiring the exercise of this court's power of supervision.

GENERAL STATEMENT

Because the facts concerning the issues here made are not disclosed in the opinion of the Court of Appeals, this statement is deemed necessary:

This suit was instituted by respondent, Rauscher, Pierce and Company, Inc., herein called Rauscher, Pierce, against petitioner, National Surety Corporation, herein called National Surety, on a Brokers Blanket Bond, conditioned to indemnify Rauscher, Pierce from:

> "(A) Any loss through any dishonest, fraudulent or criminal act of any of the Employees, committed anywhere and whether committed alone or in collusion with others, including loss of Property through any such act of any of the Employees."

The Bond contained a provision that:

> "The Underwriter will indemnify the Insured against court costs and reasonable attorneys' fees incurred and paid by the Insured in defending any suit or legal proceeding brought against the Insured to enforce the Insured's liability or alleged liability on account of any loss, claim or damage which, if established against the Insured, would constitute a valid and collectible loss sustained by the Insured under the terms of this bond * * *" (Tr. 330-331) (Ex. 3)

The loss claimed was amounts paid by Rauscher, Pierce in defense and settlement of two certain suits brought by Connecticut Mutual Life Insurance Company and State Mutual Life Assurance Company of America, herein called Water Bond Purchasers (as in the opinion of the Court of Appeals), to rescind a sale by Rauscher, Pierce to said Water Bond Purchasers of $1,365,000.00 of Travis County, Texas, Water Control and Improvement District No. 9 Bonds, which were alleged to have been purchased by Water Bond Purchasers because of misrepresentations of facts by one Volz, an employee of Rauscher, Pierce, and on which sales Rauscher, Pierce realized a net profit of $59,436.55. (R. 159)

When the suits were instituted against Rauscher, Pierce, it tendered the defense thereof to National Surety, which refused to defend on the ground that the recovery sought by the suits would not have been a loss within the coverage of its bond. Tr. 335) Rauscher, Pierce then employed attorneys and expended $32,331.07 for attorneys' fees and court costs, and settled the cases under an agreement to repurchase the bonds over a period of years at 75% of their face value (Exhibits 75 and 76), with resulting loss dependent on the value of the bond at the time of each respective purchase.

The issues here involved arose by reason of the complete about-face evidenced by the allegation of paragraph 7 of the original complaint of Rauscher, Pierce and paragraph 7 of its amended complaint.

Paragraph 7 of the Original Complaint (filed September 19, 1963), consisted of this short, unequivocal averment of facts:

> "7. The bonds, referred to in paragraphs 5 and 6 above, were sold to the stated purchasers by plaintiff for its own account, *the plaintiff having purchased such bonds previously from the Underwriter for the District.*" (Emphasis ours).

By First Amended Petition (R. 224), Rauscher, Pierce for the first time contended in an amended paragraph 7, (R. 228-229), that it purchased from the Underwriter "only after having commitments from the Connecticut Mutual and State Mutual to purchase the said bonds from it" * * * whereby any representation by Volz to Connecticut Mutual or State Mutual "was thus a representation to plaintiff as well." (R. 228-229). This was expanded in said amended complaint (R. 259-260) to include the additional allegation "that plaintiff's original commitment to purchase said bonds and its later purchase of them was decided upon by it in reliance on the same information and representations by Volz that he made to Connecticut Mutual and State Mutual. Any misrepresentation by Volz to Connecticut Mutual or to State Mutual * * * was accordingly a misrepresentation to plaintiff." (R. 259, 260).

The case was tried to the court without a jury. The trial court by its findings of fact and conclusions of law (Tr. 345-353) bottomed its judgment on the theory that the complaint of Water Bond Purchasers against Rauscher, Pierce stated a claim which if proved would have constituted a liability under petitioner's bond, and that petitioner's refusal to

defend rendered it liable for attorneys' fees and the amount paid by petitioner in settlement. (R. 345) No account was taken of the $59,436.55 net profit which Rauscher, Pierce realized on the sale to Water Bond Purchasers.

This judgment was affirmed by the Court of Appeals; but, as petitioner conceives, upon a theory different from that adopted by the trial court in its findings and conclusions, to-wit, on the theory advanced by respondent's amended complaint which was rejected by the trial court as grounds of recovery, and which is without evidence to support it.

IV.

STATEMENT AND ARGUMENT UNDER III (1)

The Court of Appeals affirmed the judgment of the trial court on a theory rejected by the trial court as grounds for recovery.

The judgment of the Court of Appeals rests on the ground that Rauscher, Pierce purchased the Water District Bonds simultaneously with the sale by it to its customers, and that the purchase by Rauscher, Pierce was induced by the same alleged fraudulent representations made by Volz to the customers of Rauscher, Pierce. This was a theory presented by Respondent in its amended complaint, directly contrary to its allegations in the original complaint that the plaintiff "purchased such bonds previously from the underwriter for the District" * * * (Paragraph 7, Original Complaint, R. 212)

The judgment of the trial court is based upon the following specific findings and conclusions of law:

"The plaintiff states it in words like this:

"The complaints of Connecticut Mutual Life Insurance Company and State Mutual Life Assurance Com-

pany of America sought to enforce an alleged liability which, if proved, would constitute a loss covered by 'Fidelity' provision A of the bonds.

"These allegations obligated this defendant to defend those suits under the provisions of the bonds conditioned to indemnify against attorney's fees and court costs of any proceeding to enforce insured's liability on account of any loss which, if established, would constitute a collectible loss under the bond." (R. 345).

The determinative conclusions of law were:

"The rescission suits brought against the plaintiff involved $1,500,000.00 and alleged and claimed the bonds were bought under fraudulent misrepresentations made by plaintiff's agents and representatives.

"When defendant was called upon to defend such suits under the terms of the bond or indemnity contract, it refused to do so upon the grounds that the suits in question did not come within the provisions of the indemnity agreement.

"By refusing to defend the suits, the defendant became bound to pay to the plaintiff the cost of procuring counsel to defend such suits and the costs of the court as set forth in the findings of fact, or to hold itself ready to pay whatever losses the plaintiff might sustain by reason of any judgment entered in such litigation." (R. 351).

These findings and conclusions constitute negative findings and conclusions on all of the facts upon which petitioner finally relied in the Court of Appeals and upon which the judgment of the Court of Appeals is based.

There is in the findings of the trial court this statement:

"The plaintiff, Rauscher, Pierce and Company, had a long-time employee, one Volz, who investigated matters and helped in making purchases and sales of bonds.

> He appears to have had the absolute confidence of his employers for a number of years. He is now dead. He was furnished by Tucker a report of the engineer and a lot of data touching the makeup of the Water District, of its assets and probable financial ability to meet its obligations. Volz wrote letters and furnished the engineer's report that had been made up for Tucker or under his supervision and that of the District, and it was upon this information and the information received by Volz in examining the property, the acreage, number of inhabitants, etc., that the purchase was made."

This is a mere random statement not tied to any ultimate findings of fact or any conclusions of law upon which the judgment is based. It constitutes a mere straw in the wind; but upon it Respondent was forced to tie its whole case, both findings of fact and conclusions of law and upon it the judgment of affirmance by the Court of Appeals must necessarily be based. Therefore, the Court of Appeals has in effect held that there was embodied within this random statement these findings:

(A) Rauscher, Pierce purchased the bonds from the underwriters only after commitment from Bond Purchasers and solely in reliance upon misrepresentations made by Volz in his letter to Water Bond Purchasers, whereby Volz perpetrated a fraud on Rauscher, Pierce.

(B) The misrepresentations made by Volz to Bond Purchasers were thus misrepresentations by Volz to Rauscher, Pierce whereby Rauscher, Pierce was induced to purchase the bonds from the District by reason of the fraud perpetrated upon it by Volz.

Clearly there was no such findings by the trial court. And since the trial court was urged to so find but did not, but to the contrary based its finding on the allegation and theory of liability of the original complaint, the function of the Court of Appeals on Respondent's abandonment of the theory of recovery upon which judgment of the trial court was based was to reverse and remand with direction to render judgment for petitioner. In ignoring the theory of recovery of the trial court, and affirming on independent findings and conclusions of its own, the Court of Appeals has set aside the findings of fact and conclusions of law of the Trial Court and rendered judgment on findings of its own having no basis in the evidence. The Court has therefore so far departed from accepted rules of law as to call for the exercise of this court's power of supervision.

Rule 52 with reference to findings by the court and the effect thereof is as follows:

> "Rule 52. Findings by the court. (a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be rendered pursuant to Rule 58; . . ."

Therefore, whether fraud was committed on Rauscher, Pierce was a fact for determination of the trial court. *Massey-Ferguson, Inc. v. Bent Equipment Company*; 283 F. 2d 12, 15, (5th Cir. 1960). It was not the function of the Court of Appeals to make this finding. *Southland Corporation v. Campbell*, 358 F. 2d 333. (5th Circuit 1966)

In the case of *Southland Corporation v. Campbell*, 358 F. 2d 333 (5th Circuit 1966), the principal issue in the case

was one of purpose of Murchison Brothers acquisition of control of a corporation. Whether the principal purpose was evasion of income tax was not considered by the trial court, and in passing upon this the Court of Appeals said:

> "The issue of 'principal purpose' is one of fact. For us to hold that the 'principal purpose' of this acquisition of control was 'evasion or avoidance of Federal income tax', when the court below failed to consider this matter, and when the facts suggest a contrary conclusion, would be wholly inappropriate."

In *Randall Foundation v. Riddell*, 244 F. 2d 803 (9th Circuit 1957), the Court of Appeals of the 9th Circuit refused to make findings on stipulations in the record for reasons shown in this brief comment:

> "Appellant urges that, since there is a written stipulation as to certain facts, this Court must disregard the findings of the trial court and decide the case on our interpretation of the documents. Some courts have presumed to state such a rule where the evidentiary facts are entirely based upon stipulation or documents. Even there, an unwarranted circumscription of the powers of the trial judge is involved. Furthermore, the appellate court would assume thereby the power of making findings of fact, which passed out of the federal system with the abolition of trials do novo. The appellate courts of the federal system have such power neither inherently nor by grant, express or implied."

Again the 9th Circuit, in *Deering-Milliken & Co. v. Modern-Aire of Hollywood*, 231 F. 2d 623, (9th Circuit 1956) said:

> "There was considerable evidence in the record from which there is a possibility a contract, partially in writ-

ing and partially oral, might be spelled out. But this would require findings of fact as to intention, consideration, and definiteness. It is not within the competence of this Court to make such findings even if it were possible upon the record here, a point upon which no opinion is expressed."

STATEMENT AND ARGUMENT UNDER III (2)

There was no evidence to support the findings upon which the judgment of the Court of Appeals is based and therefore that judgment was rendered without due process of law.

As noted under III (1), supra, the judgment of the Court of Appeals rests upon findings that Rauscher, Pierce purchased the bonds only after commitment from bond purchasers and solely in reliance upon representations made by Volz in his letter to bond purchasers.

1. The finding that Rauscher, Pierce purchased the bonds only after commitment from Bond Purchasers is not supported by evidence.

The written agreement between Rauscher, Pierce, acting by its Vice President, Kocurek, and the Underwriter, James E. Tucker & Co., is dated January 31, 1961 (Ex. 25), and is in pertinent part as follows:

> "This letter will confirm agreement whereby *we have purchased* from you the above issue of bonds at the price of 96¼ and accrued interest. Our understanding is that these bonds come to us free of all charges with the exception of the legal opinion of McCall, Parkhurst & Crowe, the cost of which will be borne by us." (Emphasis ours).

This agreement was so understood by the Underwriter, who on the same day replied by its representative R. E. Whitlock as follows: (Ex. 26).

> "I am enclosing confirmation of sale to you of $1,500,000 Travis County Water Control & Improvement District No. 9 bonds at 96.25 plus accrued interest.

Accompanying this letter was a schedule of the bonds. (Ex. 27).

On January 31, 1957 Kocurek wrote to Russ and Company as follows. (Ex. D-9).

> "Re: $1,500,000 TRAVIS COUNTY W.C. & I.D. #9, 4½%, 4¾%, 5%, Unlimited Tax and Revenue Bonds:
>
> "This will confirm agreement whereby the above bonds are being put into a selling account at the price of 98 and accrued interest, with the understanding that your firm is taking a $250,000 participation.
>
> "As agreed, we will make offerings of these bonds for the benefit of the joint account to out-of-state institutions, we to be allowed a one point takedown on any sales that may be made. It is contemplated that no general offering will be made for approximately two weeks.
>
> "We also may invite another firm to join this selling group on the same basis agreed upon with you.
>
> "We are pleased to have you associated with us in this deal as we feel sure that it will be profitable for all."

On February 4, 1957 an almost identical letter was written by Kocurek to Columbia Securities Corporation. (Ex. D-10).

In connection with the letter to Russ and Company, Kocurek was asked:

> "Isn't it a fact that when you made your deal to close it on January 31st with Whitlock, that you considered those bonds belonging to Rauscher, Pierce.
>
> "A. Provided they are regularly issued." (R. 171).

Kocurek testified by deposition in the suits by the Water Bond Purchasers, and on cross-examination in this case did not deny, that he testified in those cases that Rauscher, Pierce owned the bonds at the time it wrote the letters to Russ and Company and Columbia Securities Corporation (R. 171); nor did he deny that in answer to questions as to whether Rauscher, Pierce owned the bonds at the time of offering them to Connecticut Mutual he made these statements:

> "Sure, we didn't offer the bonds until after we owned them ourselves." * * *
>
> "I know we would not have put prices on the bonds that we did not even own, or didn't have coupon rates on." (R. 173).

In Volz's letter to Connecticut Mutual dated February 2, 1957, it was stated, "We own and will offer to you * * * an issue of $1,500,000 Travis County, Texas Water Control and Improvement District No. 9 * * * bonds." (Ex. 6).

The opening statement of the Rauscher, Pierce circular accompanying this letter is, "We own and offer" $1,500,000 * * * bonds, etc." (Ex. 7).

Connecticut Mutual's confirmations were by letters of February 12, 1957 (Ex. 9), and March 4, 1957 (Ex. 12). (See also Exhibits 10 and 11).

There is thus no factual basis for the claim that Rauscher, Pierce purchased from Tucker after the confirmations by Water Bond Purchasers of their purchase from Rauscher, Pierce; and hence the purchase of Rauscher, Pierce could not have resulted from anything contained in the letters to Water Bond Purchasers.

Rauscher, Pierce well knew the representations contained in the engineers report before Volz wrote his letters to Water Bond Purchasers. Upon the first trip of Volz to look at No. 9, he brought with him an engineering report; Mr. Kocurek looked at it and said: "if this is half as good as the engineering report says, the bonds will be very good." Thus the representations of Volz, which merely repeated the facts stated in the engineering report, could not have been a representation to Rauscher, Pierce, since it already had these representations in the engineering report.

2. Volz made no representations of fact to Rauscer, Pierce and hence there is no evidence to support the finding of the Court of Appeals that Volz perpetrated a fraud on Rauscher, Pierce.

As respects the acquisition of the bonds, Kocurek testified (R. 138) that Rauscher, Pierce had been interested in several Travis County Water Improvement District Bonds prior to No. 9, to-wit, 5, 6, 7 and 8. Mr. Volz evaluated them and made recommendations; and Rauscher, Pierce did not get into trouble on any of them. (R. 139). In the early part of 1957 Kocurek learned of District No. 9, and that Tucker was interested in it. Tucker was contacted and an attempt made

to work out a joint account with him. (R. 140). Kocurek asked Volz to inspect the District and talk to Ted Whitlock, Tucker's representative. (R. 141). On cross-examination, Kocurek went into more detail with respect to the acquisition of the bonds. On No. 8, for instance, Volz didn't like it, then Kocurek went over and both of them looked at it together. Several people in Rauscher, Pierce's office were consulted. (R. 166). When Volz came back after looking at No. 9, he brought with him an engineering report. Kocurek looked at it and said, "If this is half as good as the engineering report says, the bonds will be very good." (R. 166-167). Finally Volz, Kocurek, Halpen and Kocurek's brother got together and discussed the situation. It was a joint decision.

Volz was not an engineer, and Kocurek admitted that it was not his business to check engineering data.

> "Q. You knew he didn't purport to check the engineering data, didn't you?
>
> "A. That is correct."

Volz made no representation concerning the engineering report. (R. 168).

> "Q. So what you were relying on from Mr. Volz was his judgment about the matter, from his looking over the district, showing the proximity of it to the city, the possibility for growth; in other words, an educated judgment as to whether the district would probably be a success, is that it?
>
> "A. That is correct." (R. 168-169).

The plaintiff's entire case on the question of fraud is suc-

cinctly stated by Rauscher, Pierce's own chief witness and attorney, Mr. Carrington. (R-122, 123). His personal knowledge concededly did not go to whether Volz was guilty or not and he did not attempt to so testify. He did not attempt to conclude or make any contention that it had been concluded that Volz was guilty of actual fraud. If Rauscher, Pierce's own chief witness and attorney did not reach that conclusion, it is submitted that the Court of Appeals was not justified in reaching that conclusion. The Court of Appeals was under a misapprehension that there was evidence to establish that Volz furnished the false information. There is no such evidence. The evidence shows that the Cameron Engineering Company supplied the information to Tucker which later turned out to be false and that Volz at most copied that information without knowledge of its falsity.

Rauscher, Pierce knew what Volz said in the offering circular was what the engineering report disclosed. On Volz's return from his first visit to the District with the engineering report, he presented it to Kocurek, who commented favorably upon it. This was long before the offering circular was made up from the engineering report. Since the offering circular contained nothing that was not already represented to Rauscher, Pierce by the engineering report, it is obvious that a claim that the offering circular was a representation to Rauscher, Pierce is wholly without substance.

STATEMENT AND ARGUMENT UNDER III (3)

If the Court of Appeals should be held to be correct in integrating the transactions so as to make for a simultaneous purchase by Rauscher, Pierce from the Underwriter and sale to Water Bond Purchasers, then Judge Reeves was correct in his dissenting opinion in holding that respondent was obliged to deduct from the loss sustained by it on the transaction the net profit of $59,436.55 realized on the sale to Water Bond Purchasers.

The testimony of respondent's Senior Vice President and Director is correctly quoted by Judge Reeves in the dissenting opinion. The statement made is taken from respondent's own testimony adduced at its own instance to show that after deduction and payments of all commissions and expenses "Rauscher, Pierce made, in connection with the purchase of the bond issue from Tucker and sales to Connecticut Mutual and State Mutual, $59,436.55. This profit of $59,436.55 was retained by respondent under claim of right to the fruits of the fraud perpetrated by Volz, thereby making Petitioner's bond conditioned to indemnify against loss from fraud of its employee, a guaranty that Rauscher, Pierce may retain the fruit of fraud perpetrated by an employee on third parties.

This theory of recovery the Court of Appeals was put upon the grounds that respondent was entitled to its bargain. But this theory of recovery of profit as damages runs counter to the settled law of Texas.

The Texas rule is so well stated in the Annotations to 124 ALR 65, that we quote it here:

> "The Texas court formerly followed the minority or 'out of pocket' rule, George v. Hesse (1906) 100 Tex. 44, 93 S.W. 107, 8 LRA (NS) 804, 123 Am. St. Rep. 772, 15 Ann. Cas. 456. And see 20 Tex. Jur. 190.
>
> "Thus, in George v. Hesse, supra, the court stated: 'The difference of opinion grows out of a confusion as to the nature of the cause of action. This is not a case in which the plaintiff sues for a breach of a contract — for the contract has been performed by both parties. But it is a case in which the plaintiff sues to recover damages for fraudulent representation by which he has been induced to enter into a contract to his loss. Clearly we think the extent of his loss is the difference between the value of that which he has parted with and the value of that which he has received under the agreement.'
>
> "This doctrine was later abrogated in part by a statute which, after defiining actionable fraud with regard to 'transactions in real estate or in stock in corporations or joint stock companies,' provided that 'all persons guilty of such fraud shall be liable to the person defrauded for all actual damages suffered, the rule of damages being the difference between the value of the property as represented or as it would have been worth had the promise been fulfilled, and the actual value of the property in the condition it is delivered at the time of the contract'. Sibley v. Southland L. Ins. Co. (1931; Tex.) 36 S.W. 2d 145. And see 20 Tex. Jur. 190; 2 Tex. Jur. Supp. (1937) 1363, 1364.
>
> "It will be noted that, by its own terms, this statute applies only to transactions in real estate and in stock in corporations or joint stock companies. The Texas courts are continuing to apply the rule stated in George v. Hesse, supra, in transactions involving personal property other than stock.

In *Morriss-Buick Co. v. Pondrom*, 113 S.W. 2d 889 (1938) the Commission of Appeals in an opinion adopted by the Supreme Court said:

> "After all there is nothing mysterious about a proper measure of damages, except the mystifying cases on the subject. The end desired is actual compensation for the injury—not profit. The true measure in every case of this kind is that rule which gives to the complaining party the actual amount of his loss resulting directly and proximately from the fraud practiced upon him. The rule announced above would do this unquestionably. That followed by the trial court might result in recovery of fictitious values."

Rauscher, Pierce is taking an inconsistent position in this litigation when it claims the right to retain the profits made on the sale of the water bonds. Rauscher, Pierce contends on the one hand that it has a claim under its indemnity bond becaues of an alleged fraud on the part of Volz, and then on the other hand Rauscher, Pierce ratifies the fraud by demanding that it be allowed to retain the profit which it has made as a result of such alleged fraud. There is an element of public policy involved here which does not sanction the retention by an employer of the fruits of an alleged fraud committed by an employee against third parties. It is our position that the fruits of such alleged fraud belong to the victims thereof, namely, the water bond purchasers and should be applied to to the reduction of any indebtedness of Rauscher, Pierce to such purchasers. In other words, even if Rauscher, Pierce's claim is covered under indemnity bond, it is only entitled to be placed in status quo ante.

For the reasons stated above, the decision of the Court of Appeals in the instant case raises a question of general importance to the law which should be reviewed by this Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Lloyd E. Elliott, a member of the bar of the Supreme Court of the United States, do hereby certify that I have on this ..... day of March, 1967, mailed by first class mail, 3 copies of the foregoing Petition for Certiorari to Paul Carrington, 1700 Mercantil Bank Bldg., Dallas, Texas, attorney for respondent, Rauscher, Pierce & Company, Inc.

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Dallas, Texas 75201.

APPENDIX A

In the

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 21903

NATIONAL SURETY CORPORATION,

Appellant,

v.

RAUSCHER, PIERCE & CO., INC.,

Appellee.

Appeal from the United States District Court for the Northern District of Texas.

(December 13, 1966.)

Before RIVES, BROWN and MOORE,* Circuit Judges.

BROWN, Circuit Judge: This appeal involves the question of liability under a Brokers Blanket Bond purchased to indemnify the Insured against any loss sustained due to dishonest, fraudulent or criminal acts of its employees and for court cost and reasonable attorney's fees incurred by the Assured in defending suits arising from such acts. The District Court sitting without a jury allowed Rauscher, Pierce and Company, Inc., the Assured, recovery in the amount of $73,131.07 against National Surety Corporation,

*Of the Second Circuit, sitting by designation.

that National Surety fulfill its indemnity bond obligation to defend the suit. National Surety refused on the basis that the suit was not a claim which came within coverage of the bond. After the refusal by National Surety, Rauscher, Pierce engaged legal counsel and after extensive investigation, pretrial activity and negotiation, a compromise agreement was worked out with the Water Bond Purchasers.

The settlement took this form. The Water District was to reissue bonds containing terms, conditions and provisions more consistent with actual conditions of the district than those in the original bonds. The reissued bonds were to remain the property of the Water Bond Purchasers. Rauscher, Pierce agreed, however, to repurchase the reissued bonds within eleven years in ten installments at 75% of their face value even though the actual value at the time of purchase might be less. To the extent, therefore, that the market value of the reissued bonds was less than 75%, Rauscher, Pierce was certain to sustain a loss at these installment dates.

After the compromise Rauscher, Pierce instituted suit against National Surety to recover its costs and the damages sustained. The District Court found National Surety liable. The Court held that the loss was within the coverage of the Brokers Blanket Bond and "[b]y refusing to defend the suits, * * * [National Surety] came bound to pay to the plaintiff the cost of procuring counsel to defend such suits and the costs of the court * * *." Likewise, it became obligated "* * * to hold itself ready to pay whatever losses the plaintiff might sustain by reason of any judgment enter-

ed in such litigation." The Court allowed Rauscher, Pierce to recover $32,311.07 expended in defending the suits and $40,800 actual loss based on the repurchase of bonds on two of the agreed ten installments occurring in the interim. Also the Court found that National Surety was to reimburse Rauscher, Pierce for any future losses it might sustain due to the repurchase of the remaining installments.

National Surety urges two errors: (1) no liability exists on its part because the claim asserted by the Water Bond Purchasers did not come within the coverage of the indemnity bond, and (2) in the event it is found liable, there should be set off against National Surety's liability the profit of $59,436.55 which Rauscher, Pierce made on the sale of the bonds to the Water Bond Purchasers.

We first consider National Surety's contention that the suits by the Water Bond Purchasers did not come within the coverage of the bond. The alternatives for supporting this position are few. National Surety must show either (1) that the suits instituted by the Water Bond Purchasers did not grow out of alleged fraudulent acts committed by the employees of Rauscher, Pierce, the Assured, or (2) that no loss was in fact sustained by Rauscher, Pierce.

We easily dispose of the first. It is clear from the face of the complaints filed by the Water Bond Purchasers that the alleged misconduct was sufficient to bring the suit within coverage of the indemnity bonds.[3] Actually National Surety

[3] The complaint filed by one of them shows:

"5. In connection with the offering to and purchase by plaintiff of these bonds from defendant, defendant caused

(Footnote—continued)

does not deny that the demand of the Water Bond Purchasers was based on alleged misrepresentations by Volz acting in his official capacity as representative of Rauscher, Pierce. Rather, as near as we can discern it, National Surety contends that the claims were not within the coverage becuase Rauscher, Pierce was in a position to avoid the prosecution of the suits without actually sustaining any loss. In their suits the Water Bond Purchasers demanded a rescission of the sale. In exchange for the full purchase price paid for the bonds, they tendered a return of the bonds together

(Footnote—continued from preceding page)

to be delivered to plaintiff through the United States mails a letter from one Edward T. Volz, its then Manager, Institutional and Dealer Sales, dated February 2, 1957, with which were enclosed and transmitted a circular describing said bonds and their issuer and a letter report of Cameron Engineering Company on said bonds and district issuing them dated 18 January, 1957, signed by one Homer Trimble as a registered professional engineer; and in addition made and caused to be made various other representations of fact, oral and written, regarding said bonds prior to their purchase by plaintiff.

"7. The said Edward T. Volz was at that time and at all times material hereto an agent and employee of defendant. In forwarding the aforesaid matter to plaintiff through said mails he was acting within the scope of his authority as Manager, Institutional and Dealer Sales of defendant.

"* * *

"12. Each and every statement and representation referred to in paragraphs 5, 8, 9 and 10 above was made for the purpose of inducing plaintiff to purchase the bonds and plaintiff was entitled to rely upon each such statement and did so to its damage in making such purchase.

"* * *

"15. The representations and statements made by defendant and referred to in paragraphs 5, 8, 9 and 10 were each untrue. Each was a misrepresentation of a material fact, made by defendant in the mistaken belief that it was true and made with the intent that plaintiff should believe it and rely upon it in deciding whether or not to purchase the bonds. Plaintiff did believe and rely upon each such misrepresentation, and each was a material factor in its decision

(Footnote—continued)

with all interest received thereon to date.[4] For reasons it fully explained, Rauscher, Pierce rejected the offer to rescind as not being a prudent disposition of the claims. National Surety argues that by rejecting the offer to rescind, Rauscher, Pierce eliminated any possible liability under the indemnity bond. The reasoning runs this way. Since Rauscher, Pierce could have rescinded the sale, this would have

(Footnote—continued from preceding page)

to purchase the bonds. Plaintiff and defendant were mutually mistaken about the truth of each such representation and statement. Had plaintiff known the true state of facts as o any of these misrepresented matters it would not have purchased the bonds. * * *.

"16. Each statement and misrepresentation referred to in paragraphs 5, 8, 9 and 10 was made by defendant with reckless disregard of its truth or falsity and as to the omission of relevant material facts in connection therewith, with the intent that plaintiff should believe it and rely upon it in deciding whether or not to purchase the bonds. Plaintiff did believe and rely upon each such misrepresentation, and each was a material factor in its decision to purchase the bonds. Had plaintiff known the true state of facts and to any of these misrepresented matters it would not have purchased the bonds. * * *.

"17. Each statement and misrepresentation referred to in paragraphs 5, 8, 9 and 10 was made by defendant when said defendant knew or should in the exercise of reasonable care have known it to be false and misleading as therein stated, and with the intent that plaintiff should believe it and rely upon it in deciding whether or not to purchase the bonds. Plaintiff did believe and rely upon each such misrepresentation, and each was a material factor in its decision to purchase the bonds. Had plaintiff known the true state of facts as to any of these misrepresented matters it would not have purchased the bonds. * * *."

The complaint filed by the other purchaser was substantially the same.

[4] The complaint filed by Connecticut Mutual Life stated:

"18. Plaintiff has heretofore claimed against defendant rescission of the sale of these bonds to it and offered physical tender to defendant of said bonds together with all interest received thereon. * * *

"Plaintiff * * * has been, and is now ready, willing and able to pay over and deliver to defendant said bonds and all interest received thereon by it; and plaintiff hereby makes its continuing tender and offer to do so and to do such all other equity as may be appropriate."

The complaint filed by the other was similar.

restored the status to the position existing prior to making of the sale. Rauscher, Pierce would have had the bonds, it would have given up the proceeds received on the sale by returning the purchase price to the Water Bond Purchasers. Thus everyone would be where they were earlier, and no loss would have been sustained by anyone. Countering this argument Rauscher, Pierce made out several strong points. The first is that in early stages of the litigation, there was reasonable expectation that a meritorious defense of laches could be made out. Additionally, had the suit gone to trial, there was the great possibility that under F.R.Civ.P. 54(c) the trial Court might award damages to the Water Bond Purchasers rather than merely grant the rescission. *Travelers Ins. Co. v. Busy Elec. Co.*, 5 Cir., 1961, 294 F. 2d 139. National Surety responds by asserting that these contentions were relevant only had the suits proceeded to trial. Since trial was avoided by compromise, this means in effect that Rauscher, Pierce lost all coverage since by exercising the proffered (but rejected) rescission, all "loss" could have been avoided. But we think this argument is without merit. This puts the Assured in the position of choosing at its peril between taking the safe way out by returning to the pre-sale status or simply relinquishing its coverage under the indemnity bond by insisting in good faith on its right to defend the suit. After all, to accept without hesitation the proffered rescission would be to concede liability, to concede the total absence of a defense, either complete or partial. But with coverage denied and the demand for defense rejected, the standard was one of taking that action which a prudent

uninsured security dealer would have taken. That course might lead to defense to the bitter end or defense for awhile and compromise as the exigencies suggested. *United Services Auto Assn. v. Russom*, 5 Cir., 1957, 241 F. 2d 296, n.9 and related text. On the merits the investigation at least for a long time indicated that Rauscher, Pierce might be able to reduce the loss considerably if damages, not rescission, were awarded. What made rescission so unattractive—both to the Assured and ultimately to the Insurer, was the great drop in market value of the bonds (about 60) in 1961 in contrast to 1957. At any rate, Rauscher, Pierce invited National Surety to take over settlement negotiations and to pass on proposed alternative settlements. But this, too, was met with a refusal. The wisdom and the prudence of the settlement simply is not challenged.

National Surety urges that as the sale of the bonds was made by Rauscher, Pierce acting as principal to allow recovery for damages after rejecting rescission would be to allow the principal to recover the fruits of its own fraudulent acts. This, it claims, would be against public policy. Rauscher, Pierce does not deny that it made the sale acting as principal, but it makes the undeniable response that it was placed in this situation because of the fraudulent misrepresentations made by Volz. Although the transaction had three steps, the record bears out, and the Court impliedly found, that no commitment to purchase the bonds from Tucker was made by Rauscher, Pierce until it had a firm commitment for resale to the Water Bond Purchasers. The theory is, then, that the false information furnished by Volz was

a fraudulent misrepresentation to them as much as to the Water Bond Purchasers. Consequently, the argument runs, since Rauscher, Pierce relied on Volz throughout the transaction and its liability to the Water Bond Purchasers was brought about by no illegal acts of its own, public policy is not offended by allowing it to recover for damages it sustained as principal because of fraudulent acts of its agent. *Hendrix v. Employers Mut. Liability Ins. Co.*, E.D.S.C., 1951, 98 F.Supp. 84.

In assaying this, we think National Surety is wrong in asserting that this theory that the Assured was itself defrauded by Volz was not before the Court or passed on by it. First, the proof was directed pointedly this way. And it was quite ample. Next, it matters not that the amendment to Par. 7 of the Complaint was after the demand to defend the suits by the Water Bond Purchasers. National Surety overlooks a material fact. Although that might have a bearing on whether attorney fees were recoverable for defending that suit, the Assured's claim is not for defense alone. The bond indemnifies them from loss sustained by it (see note 1, *supra*). That loss might be a direct one, e.g., from theft, embezzlement, etc., or because of liability to third persons. Here it showed it sustained a loss because it, too, was defrauded by the agent.

Of course, as to the claims by the Water Bond Purchasers, these fit the literal terms of the coverage (see note 1, *supra*). The duty to defend, of course, is ordinarily fixed by the allegations of the damage complaint. *Green v. Aetna Ins. Co.*, 5 Cir., 1965, 349 F. 2d 919.

National Surety next asserts that if it is liable under any circumstances it should be liable only to the extent the damages exceed the profits Rauscher, Pierce made on the sale of the bonds to the Water Bond Purchasers. To this Rauscher, Pierce makes several responses including procedural ones we ignore.

Rather, we think we should face up to the merits of whether the "loss of the bargain" sustained by Rauscher, Pierce is a damage which should come within the coverage of the indemnity bond. A reading, cursory or close, of the language in the indemnity bond reveals no limitations on the type or amount of losses covered. All that is required is that such loss is due to the "* * * dishonest, fraudulent or criminal act of any of the employees, * * *."

At the outset we start with the Texas rule that doubts in construction of the bond must be resolved against the surety. *Fidelity and Deposit Co. v. Central State Bank*, Tex.Civ.App., 1928, 12 S.W. 2d 611, 613; *Massachusetts Bonding & Ins. Co. v. Texas Finance Corp.*, TexCiv.App., 1924, 258 S.W. 250, error dismissed; *First State Bank v. Metropolitan Casualty Ins. Co.*, Tex., 1935, 79 S.W. 2d 835.

But we see no doubt and no reason to import doubt. We look on this as do the businessmen to this contract. On the one hand is a stock broker who runs the risk that it assets will be lost, squandered, or dissipated through unfaithfulness of its servants. On the other, is a surety company desperately trying to interest such businesses to insure against losses by purchasing protection from it at a premium which

will—it hopes—assure it a profit. The businessman is in the business to make money—make profits. When he loses assets, he loses what profits, current or past, have produced. The loss is the loss of assets—generally money—not the origin of such money. The loss is as real in nature and amount as that sustained when a third party recovers judgment for a fraudulent or dishonest act of an employee.

This Court held as much in *Eagle Indemnity Co. v. Cherry*, 5 Cir., 1950, 182 F. 2d 298. In that case the indemnity bond was much like the present one. The indemnity bond insured against "* * * Any loss of money or other property * * * which the insured shall sustain * * * through * * * fraudulent or dishonest act or acts committed by any one or more of the employees * * *." There the president of the company using his position of trust secretly purchased steel and resold it pocketing the profits without the transaction ever going through the company. We allowed the recovery of the profits from the indemnity company.

We regard *Penn National Hardware Mutual v. General Finance Corp.*, 5 Cir., 1926, 16 F. 2d 36, pressed so heavily by National Surety, as clearly distinguishable. In *Penn National*, the assured was in the business of financing the sale of automobiles and the indemnity agreement was to indemnify the assured against any loss sustained due to default on the mortgages by the mortgagor. It was not to indemnify against losses due to fraudulent or dishonest acts of the employees. In this pre-*Erie* case we merely construed that contract in saying, "[t]he policy did not insure against

the loss of profits * * *." The nature and range of the risks, almost unlimited in scope and potential amount (subject to the bond ceiling of $500,000) make the contract here of quite a different nature. Nor are we able to see how National Surety can get any comfort from *In re: Schluter, Green & Co.*, 4 Cir., 1938, 93 F. 2d 810. It did not present our problem. And except to say that *Kramer v. Linz*, Tex. Civ.App., 1934, 73 S.W. 2d 648, is easily distinguishable, it deserves no further comment.

The faithless employee committed fraudulent acts. It involved the Assured in serious charges since, although morally innocent, it was nevertheless accountable to others for actions of its servants. To settle the claim it had, or will have, to give up much that it would have kept. These were losses.

The occurrence was covered. So, too, were the losses. It is that much worse off than it would have been had not the servant fraudulently misled it and the customer. That was the risk underwritten. It is the one to be reimbursed.

AFFIRMED.

RIVES, Circuit Judge, dissenting:

The majority points out that: "Although the transaction had three steps, the record bears out, and the Court impliedly found, that no commitment to purchase the bonds from Tucker was made by Rauscher, Pierce until it had a firm commitment for resale to the Water Bond Purchasers. The theory is, then, that the false information furnished by Volz was a fraudulent misrepresentation to them as much as to the Water Bond Purchasers."

Arnold J. Kocurek, Senior Vice President and Director of Rauscher, Pierce, testified:

> "Q. Under that calculation from your books can you also say what profit net, after all deductions and payment of commissions and expenses Rauscher, Pierce made in connection with the purchase of the bond issue from Tucker, and the sales to Connecticut Mutual and State Mutual?
>
> "A. The figure is $59,436.55. That is before overhead.
>
> "Q. Now, the net figure, not including overhead, was what per cent?
>
> "A. It was 4 per cent of the par value of the bonds."

It seems clear to me that the loss of Rauscher, Pierce under the bond should be computed from the transaction as one integrated whole. I therefore respectfully dissent from the judgment of affirmance.

APPENDIX B

Amended Findings of Fact and Conclusions of Law

(Number and Title Omitted) (Filed: July 9, 1964)

The Court, having heard and considered Plaintiff's Motion for Amendments to and Additions of Findings of Fact and Conclusions of Law, files the following Amended Findings of Fact and Conclusions of Law in lieu of the Findings of Fact and Conclusions of Law heretofore filed in this cause.

Findings of Fact

This is a suit growing out of the alleged loss in the sale of securities, the loss allegedly being protected by an indemnity bond upon which suit is brought.

The plaintiff states it in words like this:

The complaints of Connecticut Mutual Life Insurance Company and State Mutual Life Assurance Company of America sought to enforce an alleged liability which, if proved, would constitute a loss covered by the "Fidelity" provision A of the bonds.

These allegations obligated this defendant to defend those suits under the provisions of the bonds conditioned to indemnify against attorney's fees and court costs of any proceeding to enforce insured's liability on account of any loss which, if established, would constitute a collectible loss under the bond.

The plaintiff says that about the 8th of September, 1956, and again on September 8, 1959, and again on September 8,

1962, it was issued by the defendant for a valuable consideration paid policies of insurance known as defendant's "Brokers Blanket Bond," such being intended to indemnify the broker against loss under certain conditions in the conduct of his business. The bond or indemnity obligation contained the following:

> "Fidelity (A) Any loss through any dishonest, fraudulent or criminal act of any of the Employees, committed anywhere and whether committed alone or in collusion with others, including loss of Property through any such act of any of the Employees.
>
> "COURT COSTS AND ATTORNEYS' FEES
>
> "(Applicable to all Insuring Clauses now or hereafter forming part of this bond)
>
> "The Underwriter will indemnify the Insured against court costs and reasonable attorneys' fees incurred and paid by the Insured in defending any suit or legal proceeding brought against the Insured to enforce the Insured's liability or alleged liability on account of any loss, claim or damage which, if established against the Insured, would constitute a valid and collectible loss sustained by the Insured under the terms of this bond. . . ."

Arnold J. Kocurek, an executive vice-president of Rauscher, Pierce, maintains an office for the plaintiff, Rauscher, Pierce, in the City of San Antonio. It was out of this office that the transaction took place which has led to this controversy.

There was during 1956 organized in Travis County in the vicinity of the City of Austin a Water Control and Improvement District designated as No. 9, organized by

authority of the statutes of Texas, an election being held in which the landowners within the District participated.

After the District had been fully organized and legally created, it issued bonds in the amount of $1,500,000 to be used to construct a water system within the District. The District in the sale of tis bonds entered into negotiations with James C. Tucker and Company of Austin who agreed to buy the bonds when authorized.

The plaintiff, Rauscher, Pierce and Company, had a long-time employee, one Volz, who investigated matters and helped in making purchases and sales of bonds. He appears to have had the absolute confidence of his employers for a number of years. He is now dead. He was furnished by Tucker a report of the engineer and a lot of data touching the makeup of the Water District, of its assets and probable financial ability to meet its obligations. Volz wrote letters and furnished the engineer's report that had been made up for Tucker or under his supervision and that of the District, and it was upon this information and the information received by Volz in examining the property, the acreage, number of inhabitants, etc., that the purchase was made.

The bonds were issued by the District and acquired by the plaintiff from Tucker about March, 1957. After they were issued to Tucker they were immediately turned over to the plaintiff, Rauscher, Pierce.

Rauscher, Pierce concluded a sale of a portion of these bonds to the State Mutual Insurance Company about the

29th of May, 1957, and to the Connecticut Mutual by delivery and payment by Connecticut Mutual on August 5, 1957.

About February 1, 1961, these two insurance companies addressed themselves to the plaintiff demanding a rescission of the sale of such bonds and restitution in full, claiming misrepresentation made by plaintiff's salesman Volz, on which they allegedly acted. The said insurance companies wrote letters in February, 1961, demanding the rescission of the purchase of said bonds from Rauscher, Pierce.

In June, 1961, the Connecticut Mutual filed suit against Rauscher, Pierce in the United States District Court of the Western District at Austin. The complaint as filed sought rescission and restitution because of the material misrepresentations made by Volz to the Connecticut Mutual in disregard of their truth or falsity and as to the omission of relevant and material facts in connection therewith. The State Mutual also filed suit with substantially the same allegations.

The defendant National Surety Company declined to assume the defense of these suits and declined to obligate itself to bear any of the court costs or to pay any of the attorneys' fees or to supply counsel, denying liability under its insuring clause.

Counsel for plaintiff, with counsel engaged in view of the situation, went into the files and proceeded to take depositions. They found some papers in the file of Mr. Volz and obtained certain matters by taking depositions that led

counsel to believe and to advise the plaintiff that it was in jeopardy of judgment by reason of the suits that had been filed by Connecticut Mutual et al.

Upon advice of counsel so had, the suits were compromised, by the terms of which the District was to issue refunding bonds containing conditions and provisions more satisfactory than those in the original bonds, in that the plaintiff would agree to buy these refunding bonds at a price of 75 per cent of their value within eleven years, buying them in ten annual installments.

These refunding bonds remained the property of the two insurance companies, but the plaintiff, under the terms of the settlement, was to purchase the same in annual installments at 75 per cent of their face value, even though the market value might be at a less figure.

Plaintiff offered to the defendant an opportunity to determine whether or not the litigation against plaintiff by Connecticut Mutual and State Mutual ought to be compromised and settled and, if so, upon what terms. The defendant refused so to do. Both settlement agreements were reasonably and prudently entered into by plaintiff in the termination of the two law suits against it by Connecticut Mutual and State Mutual, and the terms of both such settlement agreements were reasonable and prudent.

Acting under the settlement agreements, on November 20, 1962, the plaintiff Rauscher, Pierce purchased the first of these ten installments of bonds from Connecticut Mutual

and State Mutual at the price of 75% of the face value of the refunding bonds, as stipulated in the settlement agreement.

A second installment of refunding bonds was purchased by plaintiff in accordance with the settlement agreements on March 2, 1964, for the stipulated price equal to 75% of their face value.

The Court finds that Rauscher, Pierce suffered a loss upon November 20, 1962 at the time of the purchase of the first installment of refunding bonds, of the difference between 75% of the face value of the bonds and 60% of the face value of the bonds, their market value at the time being in amount a loss of $20,400.00.

The Court finds that Rauscher, Pierce suffered a loss upon March 2, 1964, at the time of the purchase of the second installment of refunding bonds, of the difference between 75% of the face value of the bonds and 60% of the face value of the bonds, their market value at the time, being in amount a loss of $20,400.00.

In handling this litigation to defend the suits of Connecticut Mutual and State Mutual, the plaintiff paid $31,176.52 in attorneys' fees, which was a reasonable fee, and court costs in the further sum of $1,154.55.

Rauscher, Pierce has properly and timely complied with all requirements of the indemnity bonds involved in this suit concerned with notices, tenders, or proofs of loss to defendant on the claims allowed herein. Further, the de-

fendant, in communications to plaintiff, waived any other or more formal proofs of loss or demands with respect thereto than the plaintiff made to it.

Conclusions of Law

The plaintiff Rauscher, Pierce was a broker handling large sums of money in bonds and securities. For an agreed price the defendant contracted to indemnify the plaintiff against loss sustained within the terms of the indemnity bond executed for that purpose.

The rescission suits brought against the plaintiff involved $1,500,000.00 and alleged and claimed the bonds were bought under fraudulent misrepresentations made by plaintiff's agents and representatives.

When defendant was called upon to defend such suits under the terms of the bond or indemnity contract, it refused to do so upon the grounds that the suits in question did not come within the provisions of the indemnity agreement.

By refusing to defend the suits, the defendant became bound to pay to the plaintiff the cost of procuring counsel to defend such suits and the costs of the court as set forth in the findings of fact, or to hold itself ready to pay whatever losses the plaintiff might sustain by reason of any judgment entered in such litigation.

After the defendant refused to defend the suits or to furnish counsel, the plaintiff, in consultation with his own counsel, began to take depositions and testimony and, under

advice of such counsel, from the information obtained, he was advised to compromise the controversy, which was done.

The arrangement and settlement included an agreement that refunding bonds of the Water District would be issued in lieu of the bonds in controversy, and an agreement that Rauscher, Pierce obligated itself to offer to purchase in ten equal installments such refunding bonds at a price equal to 75% of the face value of such refunding bonds, even though the market value of such at the time of a particular installment might be below 75% of their face value.

The plaintiff made the purchase of the first installment of the refunding bonds at a loss which it proposes the Court to find to be $56,400.00, based on a fair market value of 35% of the face value. The second purchase of the refunding bonds in like quantity approximately one year later entailed a loss of only $20,400.00, based upon a fair market value of 60% of face value. The evidence as to the market value of the particular securities on the first purchase is not very satisfactory or convincing. The securities were new and were involved in litigation. No market quotations appeared or were shown to exist as in the case of larger institutions. They were simply worth what they would bring. The evidence shows that the Water District was in distress and that the first purchase was made under circumstances while in such distress.

In the absence of better evidence as to the value of the refunding bonds at the time of the purchase by plaintiff of

the first installment, we believe that the figure of 60% of face value which the evidence establishes to be the fair market value of the refunding bonds at the time of the purchase of the second installment to be the most reliable proof of fair market value of the refunding bonds at the time of the purchase of the first installment. The Court has accordingly used that market value in finding the loss sustained by plaintiff on both the purchase of the first installment of refunding bonds and the purchase of the second installment of refunding bonds one year later.

Upon the issue of declaratory judgment, the Court holds and determines that the possible market value of these refunding bonds is by reason of the very nature of the case quite uncertain. Austin is a growing city and the District includes a large area and there is a possibility of the bonds going higher and increasing in value. On the other hand, financial stress might cause the bonds to bring a lower price. The most that we find that the Court can accomplish here is to interpret the contract to reimburse the plaintiff in whatever loss may develop in the next installments. Whether the bonds have a market value equal to 75% of their face value may or may not be a fact at the time of the purchase of any additional installment.

We think there should be a declaratory judgment without prejudice to either party to have the amount of any loss judicially determined on the occasion of each of the remaining eight installment purchases. If the bonds will bring the obligated price, then there would be no liability. If they fall

short, then the defendant is liable for the shortage which must either be ascertained between the parties themselves or by hearing before this court or other competent jurisdiction.

7-9-1964

/s/ T. Whitfield Davidson

United States District Judge

SUPREME COURT, U.S.

Office-Supreme Court, U.S.
FILED
APR 7 1967
JOHN F. DAVIS, CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1966

No. 1140

NATIONAL SURETY CORPORATION,
Petitioner,

v.

RAUSCHER, PIERCE & CO., INC.,
Respondent.

On Petition For A Writ of Certiorari to The United States Court of Appeals For The Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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In the

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OCTOBER TERM, 1966

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NATIONAL SURETY CORPORATION,
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RAUSCHER, PIERCE & CO., INC.,
Respondent.

On Petition For A Writ of Certiorari to The United States Court of Appeals For The Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

There was no written opinion of the District Court in the present case. Its Findings of Fact and Conclusions of Law are printed as Appendix B to the Petition for Writ of Certiorari filed herein by National Surety Corporation ("National Surety"). The opinion of the Court of Appeals for the Fifth Circuit is reported at 369 F. 2d 572, and is printed as Appendix A to the Petition for Writ of Certiorari (the "Petition").

JURISDICTION

The date of the decree sought to be reviewed by National Surety is December 13, 1966, and the time of its entry was

December 13, 1966. A Motion for Rehearing filed by National Surety was overruled by the Court of Appeals for the Fifth Circuit on February 13, 1967.

The jurisdiction of the District Court was invoked by Respondent Rauscher, Pierce & Co., Inc. ("Rauscher, Pierce") under 28 U.S.C. § 1332 by reason of the diversity of citizenship of the parties. Petitioner seeks to invoke the jurisdiction of this Court under 28 U.S.C. § 1245(1).

STATEMENT

A brief statement is required, in our opinion, by several inaccuracies in the "General Statement" at pages 3 through 6 of the Petition. The opinion of the Court of Appeals (Petition, Appendix A, pages A-1 to A-13) contains a clear statement, and we deem it sufficient here merely to point out those inaccuracies in the Petitioner's Statement and in each instance to cite the evidence introduced in the trial court on the point, the pertinent Findings and Conclusions of the trial judge, and the opinion of the Court of Appeals.

1. At page 4 of the Petition, it is stated that Rauscher, Pierce "realized a net profit" on account of its purchase and sale of the Water District Bonds* to the Water Bond Purchasers.

(a) There is no evidence in the record of what the net profit of Rauscher, Pierce, if any, was in these 1957 transactions of purchasing and reselling the Water

* Hereinafter, Travis County, Texas Water Control & Improvement District No. 9 is referred to as the "Water District"; the bonds of the Water District, as the "Water District Bonds"; and Connecticut Mutual Life Insurance Company and The State Mutual Life Assurance Company of America, as the "Water Bond Purchasers," as in the opinion of the Court of Appeals.

District Bonds. There is merely a single sentence (R. 159) relating to the computation of a commission of an agent of Rauscher, Pierce in connection with such sales, based upon the profit of Rauscher, Pierce "*before overhead*," with no showing or inquiry as to what or how much overhead was involved. National Surety had nothing in its pleading about offsetting any loss by an item of profit, if any (R. 289).

(b) The Findings of Fact by the trial court on the "loss" of Rauscher, Pierce (R. 350) were not objected to in the trial court; there was no request for any findings as to any net profits which might offset any such loss (R. 294); and there were no findings as to any such net profits. Indeed, the objections of National Surety to the Findings of Fact suggested by Rauscher, Pierce on the amount of the loss were silent as to any contention that there were any "net profits" or any evidence of any (R. 324).

(c) National Surety, pointing out the single sentence in the record above mentioned, first urged the point in the Court of Appeals that there was a "net profit" and hence a setoff. That court, instead of declining to consider the contention for procedural reasons, as it could have, overruled the contention because it was immaterial as a matter of law (Petition, Appendix A, page A-11).

The record from the trial court accordingly remains clear that there was no issue about any "net profit" or indeed any evidence of any, and the opinion of the Court of Appeals

in no way supports the statement in the Petition that net profits in any amount were "realized."

2. In the last four lines of page 4 and the first twenty-four lines of page 5 of the Petition, National Surety seeks to create the impression that there is an inconsistency between the Original Complaint and the later Amended Complaints of Rauscher, Pierce as filed in the trial court. Words that were immaterial to the causes of action asserted by Rauscher, Pierce in its Original Complaint are quoted in italics (apparently for the sole purpose of casting doubt upon the propriety of the factual allegations presented for the first time in the First Amended Complaint, at which time a second and additional group of causes of action had been asserted for the first time). Theretofore three causes of action had been asserted in the Original Complaint, (i) for costs and attorneys' fees, (ii) for losses on purchases of Water District Bonds in compliance with the settlement agreements made with the Water Bond Purchasers, and (iii) for a declaratory judgment as to the right to recoup such losses when the amount each year is established, upon compliance year after year with requirements of the settlement agreements. All three causes of action in the Original Complaint were based on allegations of fraud by the Rauscher, Pierce employee Volz upon the Water Bond Purchasers. But in the light of a defense asserted by National Surety as to these original causes of action, Rauscher, Pierce amended its complaint, adding as a rebuttal to that defense and as a second and additional group of causes of action, for the same items of recovery, allegations of fraud by the said employee upon

Rauscher, Pierce.* These additional allegations are not inconsistent with any allegation necessary to recovery under the causes of action set forth in the Original Complaint. They constituted additional grounds for relief based on a supplemental check into voluminous records, all of which clearly showed indisputably that the transactions of purchase of the bonds were in three steps (by Tucker [the underwriter for the Water District]; next by Rauscher, Pierce from Tucker; and third by the Water Bond Purchasers from Rauscher, Pierce), and that the misrepresentations of Volz which were relied upon by the Water Bond Purchasers in making a commitment to buy from Rauscher, Pierce were also relied upon by Rauscher, Pierce in making its commitments to buy from Tucker and to resell the bonds, all such commitments having been made in advance of the issuance of the bonds or their acquisition by Tucker. All those allegations were important to the second and additional group of causes of action and unimportant to the first group of causes of action as asserted in the Original Complaint, which

* In view of the emphasis by National Surety in its Petition and in our brief in opposition thereto, on the differences between this first group of causes of action in the Original Complaint and the second group of causes of action asserted in the First Amended Complaint for the first time, this chronology in the trial court may aid to keep clear the contentions of the parties there: September, 1963, Original Complaint filed (R. 209); October, 1963, Motion to Dismiss it (R. 223); January, 1964, First Amended Complaint filed (R. 224); February, 1964, Order Denying Motion to Dismiss it (R. 251); May, 1964, Second Amended Complaint adding allegations about loss on purchase of second annual installment of bonds (R. 255); May, 1964, Stipulation of the parties covering a large pro-

was based upon the fraud of Volz upon the Water Bond Purchasers. These additional allegations were clearly established by evidence, Findings of the trial court, and the opinion of the Court of Appeals:

(a) In the amended complaints it was spelled out in more detail than required by the rules of pleading that the purchase by Rauscher, Pierce was effected only after it had commitments from the Water Bond Purchasers and that the representations by Volz were relied upon by Rauscher, Pierce in making the commitments for purchase and resales and in later effecting the purchase and resales (R. 228-29, 259-60). The evidence supported these allegations in detail. The Rauscher, Pierce employee, Volz, having authority to investigate and make recommendations but not to commit the company (R. 136, 138, 143), drafted the proposed offering circular for the bonds and in January 1957 enthusiastically recommended that they be acquired (R. 141-43). Thereupon Rauscher, Pierce gave a written commitment to Tucker, who expected to purchase the bonds from the Water District, to purchase them from Tucker, this expressly being a conditional commitment depending upon a legal opinion that mandatory steps, required to be taken before the bonds could be validly issued and sold, were taken (R. 144-46). Volz then forwarded to the Water Bond Purchasers the offering circulars and his explanatory letters containing his misrepresentations, and commitments to purchase from Rauscher, Pierce were obtained from the Water Bond Purchasers before the end of February (Exhibits 9, 12, 18). Steps

to be taken by the District before the Water District Bonds could be legally issued, were taken on later dates than this, almost all in March 1957 (Exhibits 29, 31, 32, 33, 35, 37, 38, 39 and 40). On the date of the last of these steps, March 22, 1957, the bonds were issued and sold by the Water District to Tucker (Exhibits 41, 42 and 43). Sales were thereupon made by Tucker to Rauscher, Pierce, also on March 22, 1957 (Exhibits 44 and 45). Thereafter, the purchase was effected by State Mutual from Rauscher, Pierce in May 1957 (Exhibits 21 and 22) and by Connecticut Mutual in August 1957 (Exhibits 14 and 15), all in accordance with the commitments made by these purchasers in February to Rauscher, Pierce. The offering circular accompanying the Volz letters contained the words that Rauscher, Pierce did offer in January the bonds which "we own and offer" * * * "when issued." All of the documents and testimony mentioned demonstrated without contradiction the truth of the new allegations in the amended complaint, as to these additional causes of action.

(b) Thereupon, at the conclusion of the trial the District Court rendered judgment for Rauscher, Pierce with Findings accepting and establishing both the original causes of action and the additional causes of action (as detailed in Section 3 of this Statement, *infra*).

(c) The Court of Appeals in its opinion expressly approved the conclusions of the trial court on each of the two groups of causes of action (see Section 3 of this Statement, *infra*).

3. On pages 5 and 6 of its Petition, National Surety states that the trial court rendered judgment against it on the original causes of action asserted and rejected the additional causes of action, whereas the Court of Appeals (so National Surety argues) has affirmed the case on the second group of causes of action allegedly rejected by the trial court (gratuitously adding that these additional causes of action were without evidence to support them, an assertion demonstrated to be erroneous by our presentation under Section 2 of this Statement, *supra*). The record from the trial court and the opinion of the Court of Appeals are both clear to the effect that the plaintiff was entitled to recover under each of the two groups of causes of action:

AS TO THE FIRST CAUSES OF ACTION

(a) The averments in the Complaint in the District Court (R. 265) alleged the charges of fraud by Volz which the earlier complaints of the Water Bond Purchasers had made. Copies of those earlier Complaints against Rauscher, Pierce (Exhibits 53, 54 and 73), alleging claims which if established would constitute a loss covered by fidelity provision "A" of the Brokers Blanket Bond, were admitted into evidence by stipulation (Exhibt 1). The opinion of the Court of Appeals quotes the provisions of the National Surety bond and the allegations of those Complaints by the Water Bond Purchasers (Petition, Appendix A, page A-2, ftn. 1 and pages A-5 to A-7, ftn. 3). The allegations of Rauscher, Pierce that National Surety was tendered defense of Water Bond Purchasers' suits (R. 264) were admitted

to be true (R. 289), and the evidence showed that this tender was a continuous one throughout the litigation with the insurance companies and until the settlement with them was consummated (Exhibits 57, 58, 60, 62, 71, 74 and 72, all admitted in evidence by stipulation, Exhibit 1). The settlement agreements of Rauscher, Pierce with the Water Bond Purchasers were introduced into evidence (Exhibits 75 and 76), again by stipulation, and the evidence that those settlements were reasonable and prudent and entered into in good faith was undisputed (R. 110-11). The allegations of loss and of court costs and attorneys' fees (R. 273-77) were supported fully by evidence (R. 21-38, 190-205 and 111-18) justifying a larger recovery than given by the trial court.

(b) The Findings of the trial court were explicit that National Surety, though obligated so to do (R. 345), declined to defend (R. 348), and though it had an opportunity to determine whether the settlements should be entered into, declined to do this (R. 349); further, that both settlement agreements were reasonably and prudently entered into (R. 349) and that the losses on which a judgment was entered were sustained (R. 351).

(c) The Court of Appeals in its opinion confirmed all of such Findings of the trial court (Petition, Appendix A, pages A-5 through A-9).

AS TO THE ADDITIONAL CAUSES OF ACTION

(a) The evidence which shows that the additional allegations under these causes of action first asserted in the first amended complaint, were fully established has been reviewed under Section 2, *supra*.

(b) The Findings of Fact of the trial court were explicit that the purchase of Rauscher, Pierce was made in reliance on information furnished it by Volz (R. 347); that the suits against Rauscher, Pierce were based on misrepresentations by Volz (R. 348); and that after National Surety declined to defend, counsel for Rauscher, Pierce proceeded with discovery depositions and in such connection found papers in the file of Mr. Volz "that led counsel to believe and to advise the plaintiff that it was in jeopardy of judgment" (R. 348-49), whereupon the suits were compromised. All of the Findings under the first causes of action, in addition to these, were of course pertinent to the second causes of action.

(c) The Court of Appeals affirmed the judgment of the trial court based on these second causes of action also (Petition, Appendix A, pages A-9 through A-10). Specifically, the court found that the proof was "directed pointedly" to the conclusion that Rauscher, Pierce was defrauded by Volz, and it referred to such proof as "quite ample" (page A-10).

As we read the Petition of National Surety, it proceeds on the theory that the Court of Appeals acted solely on the second group of causes of action, and the Petition addresses itself only to recovery based on the fraudulent representations of Volz to Rauscher, Pierce, his employer.

ARGUMENT

I.

The Decision Of The Court Of Appeals Is Clearly Correct On Grounds Wholly Unrelated To The Points Sought To Be Raised By The Petition For Writ of Certiorari

The judgment of the District Court in favor of Rauscher, Pierce had three separate components: (i) an award of attorneys' fees and Court costs incurred and paid by Rauscher, Pierce in defense of the Water Bond Purchasers' lawsuits; (ii) an award of the amount of loss suffered by Rauscher, Pierce because of its required purchases of the first two installments of Water District Bonds from the Water Bond Purchasers under the settlement agreements with them; and (iii) a declaratory judgment that Rauscher, Pierce is entitled to recover any loss suffered by it because of future purchases of installments of Water District Bonds under those settlement agreements.

Each portion of that District Court judgment was based upon two separate bases for recovery presented by Rauscher, Pierce in its pleadings before the District Court, and was affirmed by the Court of Appeals on the basis of both of those theories. The points sought to be raised by National Surety in its Petition for Writ of Certiorari concern only the sufficiency of the Findings of Fact by the District Court, and the sufficiency of the evidence to support those Findings, with regard to only one of these, referred to in our Statement as the second group of causes of action. The Petition does not attack the legal correctness as a basis of recovery of the grounds asserted in the first group of causes

of action nor the sufficiency of the Findings of Fact or evidence to support the recovery to which Rauscher, Pierce has been held entitled on this group of causes of action, based upon fraud on the Water Bond Purchasers, perpetrated by Volz, the employee of Rauscher, Pierce. In addition, the decision of the Court of Appeals upon National Surety's "profits realized" point (Point 3 in its Petition) was clearly correct upon grounds which that Court did not reach in its opinion, but which were presented to it by Rauscher, Pierce by brief and oral argument.

Therefore, a Writ of Certiorari should not be granted in this case, because this Court, if it considered the merits of the case, would likely affrm the decision of the Court of Appeals without reaching the points of alleged error presented by the Petition for Writ of Certiorari.

A. ***The Court of Appeals' Affirmance of the Award of Attorneys' Fees and Court Costs Was Clearly Correct, and Is Unchallenged by the Petition for Writ of Certiorari.***

National Surety's points (1) and (2) concern only whether or not there were Findings and evidence to support Findings that Rauscher, Pierce relied upon the misrepresentations by Volz. These points do not in any way concern the correctness of the District Court's award of attorneys' fees and Court costs. That award, simply, is unchallenged by the Petition for Writ of Certiorari.

The Broker's Blanket Bond upon which Rauscher, Pierce sued National Surety provides that National Surety will indemnify it against Court costs and reasonable attorneys' fees incurred and paid "in defending any suit or legal pro-

ceeding brought against the Insured to enforce the Insured's liability or alleged liability on account of any loss, claim or damage which, if established against the Insured, would constitute a valid and collectible loss sustained by the Insured under the terms of this Bond . . . ." (R. 330-31; Exhibit 3.) The District Court found (R. 348) that the complaints filed by the Water Bond Purchasers against Rauscher, Pierce sought recovery.

> "because of the material misrepresentations made by Volz to . . . [them] in disregard of their truth or falsity and as to the omission of relevant and material facts in connection therewith."

The material allegations of those complaints are set forth in footnote 3 to the opinion of the Court of Appeals. (Petition, Appendix A, pages A-5 through A-7.) In effect, those complaints alleged that Rauscher, Pierce's employee Volz made misrepresentations to the purchasers which he knew or should have known were false and misleading or (alternatively) which he made with reckless disregard of their truth or falsity. The complaints then alleged that Rauscher, Pierce, as Volz' employer, was responsible for his alleged actions. If the Water Bond Purchasers had established the truth of those allegations, and recovered from Rauscher, Pierce by reason of its vicarious liability, Rauscher, Pierce would have suffered a loss by reason of a "dishonest, fradulent or criminal act" of one of its employees.

Upon consideration of those allegations and the Findings of the District Court, the Court of Appeals held that

> "It is clear from the face of the complaints filed by the Water Bond Purchasers that the alleged misconduct was

> sufficient to bring the suit within coverage of the indemnity bonds." (Petition, Appendix A, page A-5.)

Under Texas law, National Surety's duty to defend the Water Bond Purchasers' suits or to indemnify Rauscher, Pierce for the costs of those defenses, is to be judged solely by the allegations of the complaints filed by the Water Bond Purchasers. It does not matter that other causes of action were alleged by the Water Bond Purchasers against Rauscher, Pierce which may not have been covered by the Bond, and it would not have mattered even if the allegations of Volz' fraud had been wholly groundless. The Supreme Court of Texas, in *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W. 2d 22, 24 (1965), held:

> "We think that in determining the duty of a liability insurance company to defend a lawsuit the allegations of the complainant should be considered in the light of the policy provisions without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof."

See also, *Maryland Casualty Co. v. Moritz*, 138 S.W. 2d 1095 (Tex. Civ. App. 1940, error refused by Texas Supreme Court); *Liberty Insurance Company of Texas v. Rawls*, 358 S.W. 2d 920, 928 (Tex. Civ. App. 1962).

B. *The Court of Appeals Was Correct in Affirming the District Court's Award of Rauscher, Pierce's Losses and in Affirming the Declaratory Judgment Awarded, on the Basis of Its First Group of Causes of Action, Which Is Unchallenged by the Petition for Writ of Certiorari.*

Throughout the present litigation, Rauscher, Pierce has urged as its first bases for causes of action that, upon

National Surety's repeated refusal to assume the defenses of the Water Bond Purchasers' actions or to participate in any way in those defenses or in consideration of whether or not those lawsuits should be settled, it had the right in good faith to make a settlement which was reasonable and prudent and which was binding upon National Surety.

The facts before the District Court were undisputed. The settlement agreements with the Water Bond Purchasers were made upon advice of Rauscher, Pierce's counsel, who after discovery proceedings had been completed in the Water Bond Purchasers' litigation concluded that there was a substantial hazard of a finding that there had been actual fraud practiced by Volz and who based his recommendation to Rauscher, Pierce that it settle upon the danger of such an adverse finding; at no time was Raushcer, Pierce willing to consider settlement of those lawsuits upon the basis of a danger of liability without fault. (R. 95-99.)

The District Court found that the settlement agreements were entered into "upon advice of counsel" and that both were "reasonably and prudently entered into." (R. 349.)

The Opinion of the Court of Appeals makes clear that it affirmed the District Court's judgment upon the basis of these first causes of action of Rauscher Pierce, as well as upon the basis of Rauscher, Pierce's additional causes of action which are attacked by the Petition for Writ of Certiorari. As the Court of Appeals put the matter (Petition, Appendix A, pages A-8 and A-9):

> "But with coverage denied and the demand for defense rejected, the standard was one of taking that action

> which a prudent uninsured security dealer would have taken. That course might lead to defense to the bitter end or defense for awhile and compromise as the exigencies suggested . . . . At any rate, Rauscher, Pierce invited National Surety to take over settlement negotiations and to pass on proposed alternative settlements. But this, too, was met with a refusal. The wisdom and the prudence of the settlement simply is not challenged."

Rauscher, Pierce's recovery on its first causes of action, sustained by the District Court and affirmed by the Court of Appeals, is solidly based on clear holdings of the Supreme Court of Texas. That Court, in *Gulf, Colorado & Santa Fe Railway Co. v. McBride*, 322 S.W. 2d 492 (1958), established the following rule of law: If the indemnitee notifies the indemnitor of the claim against it, and calls upon the indemnitor to defend the claim, and if the indemnitor refuses to do this the indemnitee has the right to make a reasonable settlement in good faith. If the allegations of the claim were such as to require the indemnitor to defend it, the indemnitor must pay any loss resulting from such a settlement after the indemnitee shows "that it made the settlement . . . in good faith, and that it was a reasonable and prudent settlement." *Accord: Mitchell's, Inc. v. Friedman*, 303 S.W. 2d 775 (Tex. 1957); *Luton Mining Co. v. Louisville & N.R. Co.*, 123 S.W. 2d 1055 (Ky. 1938) (cited with approval in *Gulf Colorado & Santa Fe Railway Co. v. McBride*, 322 S.W. 2d at 495-496).

C. *The Decision of the Court of Appeals in Overruling National Surety's "Net Profits" Point Was Correct on Grounds Which That Court Did Not Reach.*

By point (3) in the Petition for Writ of Certiorari in this case, National Surety seeks to attack the holding of the

Court of Appeals that Rauscher, Pierce is entitled to recover from National Surety, as a part of its loss under the Broker's Blanket Bond, any profit it might have realized in the sales to the Water Bond Purchasers but for Volz' alleged misrepresentations. National Surety's point, apparently, is that the Court of Appeals' decision was incorrect as a matter of Texas law. As we shall make clear later in this brief, we believe National Surety's view of Texas law is wholly incorrect, but before that we wish to point out that the Court of Appeals' decision on this question was correct on two other separate grounds, presented to it but which it did not reach in its consideration of the case. Each of those other grounds would likely lead this Court to affirm the Court of Appeals' decision without reaching the alleged conflict between that decision and applicable Texas law.

First, National Surety never in any manner presented to the District Court the proposition that the loss to Rauscher, Pierce should be offset by the amount of any alleged prior "profit". (See Section 1 of "Statement," *supra* p. 3.) This question of setoff was raised for the first time by National Surety in its brief to the Court of Appeals.

The more convincing authorities on the matter hold that an issue of fact or law must be presented in some manner to the trial court before it may properly be presented on appeal.

> "While it was not necessary that he request a finding [under Rule 52(a)], it was necessary that he make known to the court his objection to the action taken by it and state the grounds of the objection. If the Administrator had any objection to the findings an-

> nounced by the District Court, such objection should have been registered with that court."

Fleming v. Van Der Loo, 160 F. 2d 906, 909-10 (D.C. Cir. 1947); see also, *United States v. Pendergrast*, 241 F. 2d 687 (4th Cir. 1957). It is a matter of simple justice that a party ought to make known to the trial court and to its adversary the action it desires taken or the reason why it believes some action should not be taken, so that the trial court may have an opportunity to consider the party's point before reaching a decision and so that the adversary may have an opportunity to present evidence and arguments directed to the point. This principle is also emphasized in Rule 46 of the Federal Rules of Civil Procedure, which, while making formal exceptions to rulings or orders unnecessary, requires that a party make known "to the court the action which he desires the court to take or his objection to the action of the court and his grounds therefor . . ."

Secondly, there was simply no evidence in the record before the Court of Appeals that there was any "net profit" to Rauscher, Pierce in connection with the transaction. The Petitioner herein relies upon a single sentence of a witness, in which he refers to how he computed payments of commissions to salesmen in 1957 by referring to a "profit before overhead." This passing reference, not called to the attention of the District Court and never developed in the evidence before the District Court by either party, cannot by any stretch of imagination be converted into evidence of what in mid-1957 were the "net profits" of Rauscher, Pierce,

what offsetting items then existed to diminish or eliminate that figure, and what items of expense or overhead with reference to the Water District Bonds had arisen from mid-1957 until the trial of the case in the District Court to diminish or eliminate that figure. Further, in the words of the Court of Appeals (Petition, Appendix A, page A-9), there had been "the great drop in market value of the bonds (about 60) in 1961 in contrast to 1957." The reasons for this marked diminution in value were wholly unrelated to Volz' conduct, were amply set forth in the record before the District Court, and were undisputed. Only confusion results from comparing an alleged 1957 "net profit," not reflected in the record, with the situation as it existed in 1961 and after. In brief, there is no evidence in the record of any "net profit" to Rauscher, Pierce, and the silence of the record is attributable solely to the failure of National Surety (the party with the burden of showing any setoff) to present it to the District Court.

II.

The Decision Of The Court Of Appeals Was Correct Upon The Additional Grounds Upon Which It Relied And Which Are Attacked By The Petition For Writ Of Certiorari.

A. *Contrary to Petitioner's Points 1 and 2, There Were Findings of Fact In the District Court to Support the Decision of the Court of Appeals, and Those Findings Were Supported By Ample Evidence In the Record, on the Question of Loss Suffered by Rauscher, Pierce as the Result of Fraudulent Representations to it by Volz.*

As has been pointed out above, Petitioner's points 1 and 2 do not attack the correctness of the Court of Ap-

peals' affirmance of the District Court's award of attorneys' fees and Court costs to Rauscher, Pierce. Further, those points do not raise any question of the correctness of the Court of Appeals' decision on the first group of causes of action relied upon by Rauscher, Pierce. Rather, Petitioner's points involve only construction of Findings of Fact, and of evidence to support those Findings, relating to Rauscher, Pierce's recovery on its second group of causes of action, arising out of fraudulent misrepresentations to it by Volz.

The additional facts fundamental to these causes of action are that Rauscher, Pierce relied upon the same alleged misrepresentations as did the Water Bond Purchasers, when it determined to commit itself conditionally to purchase the Water District Bonds and again later when it concluded the purchase of the bonds from Tucker and their resale.

The Court of Appeals held that National Surety was wrong in asserting that this additional basis for recovery "was not before the Court or passed on by it." (Petition, Appendix A, page A-10.) First, the District Court found that:

> "The bonds were issued by the District and acquired by the plaintiff from Tucker [the underwriter for the Water District] about March, 1957. After they were issued to Tucker they were immediately turned over to the plaintiff, Rauscher, Pierce.
>
> "Rauscher, Pierce concluded a sale of a portion of these bonds to the State Mutual Insurance Company about the 29th of May, 1957, and to the Connecticut Mutual by delivery and payment by Connecticut Mutual on August 5, 1957." (R. 347-48.)

The fair construction of these Findings is that of the Court of Appeals, that is, that Rauscher, Pierce did not own the Water District Bonds, and was not unconditionally committed to purchase them, when the Water Bond Purchasers committed themselves to buy during mid-February, 1957. Secondly, there is this unequivocal finding of fact by the District Court (R. 347):

> "The plaintiff, Rauscher, Pierce and Company, had a long-time employee, one Volz, who investigated matters and helped in making purchases and sales of bonds. He appears to have had the absolute confidence of his employers for a number of years: He is now dead. He was furnished by Tucker a report of the engineer and a lot of data touching the makeup of the Water District, of its assets and probable financial ability to meet its obligations. Volz wrote letters and furnished the engineer's report that had been made up for Tucker or under his supervision and that of the District, and *it was upon this information and the information received by Volz in examining the property, the acreage, number of inhabitants, etc., that the purchase was made.*" (Emphasis supplied.)

Petitioner has difficulty in explaining away this Finding of Fact by the District Court and can say no more than it is a "mere random statement." (Petition, page 8.) Petitioner's difficulty, obviously, is simply that it does not wish to accept the correctness of a Finding that Rauscher, Pierce relied upon the representations by Volz when negotiations were conducted for its purchase of the bonds and their resale, and later when it was purchasing and reselling them.

The Court of Appeals, in discussing Rauscher, Pierce's second group of causes of action, commented that:

> "[T]he proof was directed pointedly this way. And it was quite ample." (Petition, Appendix A, page A-10.)

In fact, the evidence in the record supporting these Findings of Fact by the District Court is so ample that, in this Brief, we may only give a short summary of it. That evidence conclusively shows that Volz was charged with the responsibility to investigate and make recommendations to his employer with regard to the Water District (R. 138, 143); that Volz visited the District several times and talked with the engineer and the underwriter for the District (R. 141); that the preliminary draft of offering circular containing the misrepresentations was prepared under the direction of Volz and he gave a copy of it (along with a copy of the engineer's report containing misrepresentations) to Arnold J. Kocurek, the Rauscher, Pierce officer charged with deciding whether or not to purchase the Bonds (R. 141-42); that Volz represented to Kocurek that the statements in the draft of offering circular were true and that Kocurek would not have committed the company to buy the bonds without the representations and recommendations made to him by Volz (R. 165, 169); and that when Kocurek made the final decision to waive the conditions to Rauscher, Pierce's commitment to purchase the Water District Bonds, he talked to Volz, relied upon Volz and his recommendations and representations, and without those representations and recommendations by Volz would not have gone forward with the

purchase (R. 152, 153, 165). Thus, the misrepresentations alleged to have been made to the Water Bond Purchasers by Volz were shown by the evidence to have been made equally to Rauscher, Pierce by Volz and to have been relied upon by it.

With regard to the conditional nature of Rauscher, Pierce's commitment to purchase the Water District Bonds from the underwriter for the Water District, the evidence is equally conclusive. Arnold J. Kocurek testified before the District Court that on January 31, 1957, he made a conditional commitment for Rauscher, Pierce to purchase the issue from the underwriter "when acquired and only if acquired by Tucker." (R. 147-148.) The commitment to purchase was conditional upon the legal and proper issue of the bonds, and the receipt by Rauscher, Pierce of an opinion of legality of issue from a Dallas, Texas, law firm. (R. 144-46, 149.) That opinion was required, in addition to the expected opinion of an Austin, Texas, law firm which was counsel for the Water District, because Rauscher, Pierce anticipated that it would be required by prospective purchasers. (R. 144-45.)

The commitments to purchase by the Water Bond Purchasers were made in mid-February, 1957. Before the Water District Bonds could be legally issued, a number of required steps had to be taken, and were taken, all after the January 31, 1957, conditional commitment to purchase by Rauscher, Pierce and all after the commitments of February, 1957, by the Water Bond Purchasers. Some of these required steps were the following: The Water District's

Amendatory Bond Order (Ex. 29); Resolution of the Board of Water Engineers of the State of Texas (Ex. 31); Non-Litigation Certificate by the State District Clerk (Ex. 33); Boundary Correction Order by the Water District (Ex. 35); the District's Boundary Certificate (Ex. 36); Waiver of Option to Purchase by the State Board of Education of Texas (Ex. 37); Opinion of the Attorney General of the State of Texas (Ex. 38); Registration of the Bonds by the Comptroller of the State of Texas (Ex. 39); and Opinion by the Attorneys for the Water District (Ex. 40). Until each of these steps, and others reflected in the record, had been taken, Rauscher, Pierce's commitment to purchase the bonds from the underwriter remained unconditional. Most importantly, that commitment remained conditional until Rauscher, Pierce consciously waived its requirement that it receive the opinion of the Dallas law firm. Arnold J. Kocurek intentionally waived that requirement, and determined to go forward with the purchase in late March, 1957, because he was sure that the opinion would be received very soon. (R. 152-53, 180.) The only item of purported evidence which Petitioner has pointed to, which might lead a Court to believe that the January commitment of Rauscher, Pierce was unconditional, is the letter of January 31, 1961, from Kocurek to the underwriter (Ex. 25) which is quoted in part on page 11 of the Petition for Writ of Certiorari. However, Mr. Kocurek's testimony in the District Court was uncontradicted to the effect that in the securities trade an agreement to purchase on "when issued" conditions is referred to as a "purchase" and an agreement to so sell is referred to as a "sale." (R. 178-79.)

Thus, the Court of Appeals was clearly correct in determining that the District Court had made Findings of Fact on the issues in question, and that those Findings were amply supported by all this evidence in the record.

B. *There Is No Conflict Between the Decision of the Court of Appeals and the Law of the State of Texas.*

By its Point (3) National Surety in its Petition for Writ of Certiorari has sought to establish a conflict between the Court of Appeals' holding, that a loss of profits is a "loss" to the insured under a Broker's Blanket Bond, and the law of the State of Texas. Again, this point has no bearing on the question whether or not the Court of Appeals was correct in affirming the District Court's award of attorneys' fees and Court costs to Rauscher, Pierce, and it can have no bearing upon the correctness of that Court's affirmance of the declaratory judgment for future losses granted by the District Court.

Petitioner refers the Court to authorities with regard to Texas law which are wholly inapplicable to the present case. Those authorities involve the appropriate measure of damage under Texas law in a case involving an action for fraudulent misrepresentation brought by the party defrauded against the person who made the misrepresentations. The present case is one involving construction of an indemnity bond, which provides that National Surety will pay Rauscher, Pierce for "any loss through any dishonest, fraudulent or criminal act of ony of the Employees . . . ." Thus, the question in this case is not that of the measure of damage

in a fraud action, but the question of the meaning and construction of the words "any loss" in the Broker's Blanket Bond.

On the matter of construction of these words of the bond, Texas law amply upholds the decision of the Court of Appeals. We begin, as did that Court, with the well established Texas rule that doubts in regard to the construction of a fidelity bond must be resolved against the surety. *First State Bank v. Metropolitan Casualty Ins. Co.*, 79 S.W. 2d 835, 840 (Tex. 1935); *Massachusetts Bonding & Ins. Co. v. Texas Finance Corp.*, 258 S.W. 250, 252 (Tex. Civ. App. 1924, error dismissed by Texas Supreme Court); *Fidelity & Deposit Co. v. Central State Bank*, 12 S.W. 2d 611, 613 (Tex. Civ. App. 1928). The reason for this rule of construction, as stated by the Texas Court of Civil Appeals in 1908, is that the

> "company is engaged in the business of making such contracts of indemnity for a consideration, and that it prepared the obligation and selected the language used," *Griffin v. Zuber*, 113 S.W. 961, 963.

"Loss" is not a word of precise meaning, but the Court of Appeals, correctly in our view, pointed out that when a businessman is required to pay over money to a third party, he loses assets, and he is not interested in whether or not those assets were generated by "profits" sometime in the past—they no doubt were. The payment of his money is a "loss" in a very real sense, and to construe the Broker's Blanket Bond otherwise would be to render its proffered protection illusory. The only case applying Texas law which has involved a determination of whether or not loss of

profits is a loss within the meaning of a fidelity bond, which we have found, is *Eagle Indemnity Co. v. Cherry*, 182 F. 2d 298 (5th Cir. 1950) (affirming a judgment of the United States District Court for the Northern District of Texas, Dallas Division, sitting in diversity). There the Fifth Circuit held that the fidelity bond protected the employer against a loss of profits which it could have earned had its employee not acted in a disloyal manner. The Court of Appeals in this case correctly followed its prior decision in the *Eagle Indemnity* case, thereby avoiding any conflict of authorities.

III.

The Matters Raised By Petitioner's Points, If Reached By This Court On The Merits, Are Of No Importance Beyond The Present Litigation And Are Essentially Matters Of Fact.

We feel certain that this Court, in considering the foregoing arguments that the decision of the Court of Appeals was correct both with and without regard to the points raised by the Petition for Writ of Certiorari, will have noticed the paucity of legal questions involved in the matters raised by the Petition, the unimportance beyond this litigation of the one legal principal presented by Petitioner, and that the Petition presents primarily questions of fact without any application beyond the present cause.

There is no constitutional principle, involving the Federal Constitution or any state constitution, important or unimportant, presented by the Petition for consideration. There is no question of Federal statutory law, important or unimportant, presented by the points Petitioner makes. There

is no question of state statutory law, important or unimportant, presented. The only legal question raised concerns the state of case law in Texas with regard to the proper construction of the words "any loss" in a fidelity bond. That question, if it becomes important to any other litigants, would be important to only a few in number, and is not of sufficient importance to justify this Court considering the matter on its merits.

The balance of the points presented by the Petition have no application or importance beyond this litigation. They involve merely the proper construction of specific Findings of Fact by a District Court and whether or not those Findings are supported by evidence.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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/s/ FLETCHER L. YARBROUGH

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April 6, 1967

CERTIFICATE OF SERVICE

The undersigned, counsel of record herein for Respondent Rauscher, Pierce & Co., Inc., does certify that service of the above and foregoing Brief for Respondent in Opposition to Petition for a Writ of Certiorari, was this day accomplished pursuant to Rule 33 (1) of the Rules of this Court by depositing 4 copies of same in a United States Post Office mail box, with first class postage prepaid, by certified mail with return receipt requested, addressed to Lloyd E. Elliott, counsel of record herein for Petitioner National Surety Corporation, at his post office address of record herein.

April 6, 1967

/s/ PAUL CARRINGTON

PAUL CARRINGTON,
Counsel for Respondent.